

# M&Y INTERNATIONAL FINANCIAL SERVICES NEWSLETTER



## M&Y International Financial Services

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## What qualifies as nontaxable income?

What does the IRS tax? Just about everything.

The Internal Revenue Code defines taxable income as gross income minus deductions. And gross income, federal law says, “means all income from whatever source derived.”

That’s a lot of territory, covering not only earned income like wages but also unearned income from investments. If you operate on a cash-free basis, the value of items you receive as a barter exchange is taxable, too. So are gambling jackpots and prize winnings.

And the IRS doesn’t care one bit how you get your money, specifically saying, “Income from illegal activities ... must be included in your income on Form 1040, line 21, or on Schedule C or Schedule C-EZ (Form 1040) if from your self-employment activity.” Al Capone learned that hard lesson.

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*“The only thing worse than owing taxes is thinking you don’t — and then getting a bill from the IRS.”*

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## 10 examples

### 1. Educational assistance from your boss

You can exclude from your income up to \$5,250 of qualified employer-provided educational assistance.

### 2. Adoption help from your employer

If your company helps you cover the cost of adopting a child, that’s not taxable income. For the 2016 tax year, the tax-free employer-provided adoption assistance is \$13,460 per child. It increases to \$13,570 per child in 2017.

### 3. Payments for caring for children

Most divorced parents know that child support payments are not taxable income. Similarly, government payments made to foster parents for their care of children officially placed in their homes generally are tax-free.

#### **4. Workers' compensation**

If you get benefits for a workplace-related illness or injury under federal or a state's compensation law, that money is tax-exempt.

#### **5. Life insurance proceeds**

When these are paid to you because of the death of the insured person, the amount is tax-free.

#### **6. Carpooling**

Do you collect cash from your commuting coworkers when you drive them to and from work? That's tax-free money for gas and wear on your vehicle. Just make sure you don't charge so much that your unofficial transportation service becomes a profit-making business. That would convert it to a taxable enterprise.

#### **7. Energy conservation subsidies**

You upgraded your home's air conditioning system and got a rebate from your electric service provider as a reward for your energy saving efforts. That financial thank-you from a public utility, either as a direct or indirect subsidy for the purchase or installation of a home energy conservation measure, is tax-free.

#### **8. Municipal bond earnings**

Interest you earn on state and local government obligations generally is not taxable. Even better, if you buy muni bonds issued by the state in which you live, earnings usually aren't taxable at the state level either.

#### **9. Gifts**

Financial gifts, either money or other assets, that you receive are not taxable. If any federal gift tax is owed on the present, it is the giver who owes the tax.

#### **10. Inheritances**

There is no federal inheritance tax, so everything your great-uncle left you doesn't pose any immediate tax issues. However, if he left you an asset that produces income, such as a dividend-paying stock, then you will owe tax on the money the bequest earns.

## **Maybe, maybe not**

In some cases, a certain type of payment might be tax-free while another, very similar one will lead to a tax bill. Here are three instances where you need to take special care.

- Some legal settlements are nontaxable, but others are. To determine whether you owe the U.S. Treasury a piece of your court award, consider what the settlement replaces and why it was granted. Proceeds for emotional distress or mental anguish originating from a personal physical injury or physical sickness, for example, typically are tax-free. However, court-awarded punitive damages are taxable, even if the punitive damages were in connection with a settlement for personal physical injuries or sickness.
- Social Security is generally tax-free if it's your only source of income. But if you have other income — for example, from a part-time job, some taxable pension or investment earnings — you could owe federal tax at your ordinary income tax rate on up to 85% of your federal government retirement benefits.
- Home-sale proceeds are [tax-free for many](#), so long as the profit is at or below a certain threshold: \$250,000 for a single home seller, \$500,000 for a married couple filing a joint return. But if you make a real estate killing, the IRS collects tax on the amount you pocket in excess of those thresholds. The good news is that the applicable tax is at the usually lower [long-term capital gains tax rate](#).

Remember, too, that in some cases your personal circumstances, such as the amount of other money you make, could have an effect on apparently tax-free situations.